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Summary

¶1. The Ministry of Finance (MOF) has recently come out with several plans to deal with a serious economic slowdown in Israel caused by the global financial crisis. The first plan introduced by the MOF is aimed at accelerating economic growth, with a primary emphasis on investment in infrastructure. Another plan recently announced by the MOF addresses the capital markets, especially the problems in the corporate bond market. The final and most controversial plan recently presented by the government is its proposal for providing a safety net to pension and long-term fund (provident fund) savers. The first two plans have been fully approved by the cabinet and the Knesset Finance Committee and await full Knesset approval. After much wrangling and political drama, the cabinet approved the pension safety net plan, which now awaits action in the Knesset Finance Committee. End Summary.

Accelerate Infrastructure Building

¶2. The first plan introduced by the MOF aims to accelerate economic growth, mainly through investment in infrastructure. The plan calls for spending of NIS 21.7 billion (USD 5.7 billion) on basic infrastructure projects, especially transportation and water. The plan also addresses professional training and education. It increases the budget of the chief scientist, establishes a loan fund for medium sized businesses, and expands a similar type of small business loan fund. In addition, there are numerous other provisions, such as one allowing businesses with sales turnover of less than NIS 15 million to report and pay Value Added Tax on a bimonthly basis, instead of monthly. The plan also includes a provision to help exporters obtain financing.

Big Spending Has Little Short-Term Impact

¶3. Economists and analysts have generally welcomed the spending plans. Bank Leumi economists have commented in their newsletters that government intervention and an expansive monetary policy are needed to accelerate economic activity. However, they note that the infrastructure spending portion of the government's plan will strengthen the economy in the long run and not do much for the short and medium terms, which the plan is ostensibly intended to address. Bank Leumi's growth forecast for 2009 is around 2 percent, with most other economists coming in with forecasts in the same general area--from 1.7-2 percent. With population growth expected to continue at about 1.7 percent, this puts GDP per capita growth at close to zero. Most economists are also forecasting a significant decline in state tax revenues in 2009 due to the decline in economic activity. Ofer Klein of Harel Insurance forecasts that state tax revenues could be as much as NIS 30 billion (USD 7.6 billion) lower than planned when the 2009 budget was formulated. There is wide agreement that infrastructure spending, while good in the long run, will not do much to deal with the short term problems represented by these figures.

Bolster the Capital Markets

¶4. Another plan recently announced by the MOF addresses the capital markets, especially the problems in the corporate bond market. The plan, which totals about NIS 11 billion (USD 2.89 billion) to strengthen the capital markets, has several aspects. The government will provide a NIS 6 billion guarantee for the banking system to encourage the expansion of credit. NIS 5 billion would also be allocated to establish investment funds to assist companies which have problems redeeming bonds by providing capital to the companies and restructuring the debt and extending it over a longer period of time. The MOF made clear in its announcement that these funds would be available for companies who are active primarily in Israel and employ most of their workers in the country. By establishing a vehicle to help bond issuers reach repayment arrangements with the issuers, the plan is intended to enable companies to meet their commitments and thereby reduce the level of uncertainty in the economy. Finally, the government intends to introduce tax legislation that would encourage the flow of foreign investment into Israeli capital markets, with a particular focus on the corporate bond sector.

Banks Still Don't Want to Lend

¶5. Reaction to the capital markets plan has also been mixed. When it was announced, the Tel Aviv Bond indices rose moderately. However, many banks are wary of accepting government guarantees if by doing so they are required to begin lending again and assume what they deem to be unwarranted risks. Many bankers are simply not interested in taking on any risk at all during such a volatile period, even if the government is willing to share part of the risk.

Corporate Bonds Coming Due

¶6. The 1 December issue of the Marker (a respected financial newspaper) gave a breakdown of the amount of money that the most prominent Israeli businessmen (the "tycoons") will have to pay to redeem bonds coming due in the period from December 2008 through December 2009. Nochi Danker needs to repay NIS 3 billion (USD 752 million), Eliezer Fishman NIS 1.1 billion (USD 275); Yitzhak Tshuva NIS 696 million (USD 175 million) and Lev Leviev NIS 589 million (USD 147 million). According the article, the amount of money needed during this period to redeem or pay interest on corporate bonds in aggregate will vary from a low of NIS 660 million (USD 165 million) in some months to as high as NIS 2 billion (USD 500 million) in others.

Pension Safety Net Caused Controversy

¶7. The other and most controversial plan recently presented by the government is its proposal for providing a safety net to pension and long-term fund (provident fund) savers. This proposal, coming as it did in a period leading to national elections, became bound up in political controversy, causing friction between Finance Minister Bar-On, and Prime Minister Olmert, the Chairman of the Histadrut Labor Federation, Ofer Eini, who threatened a general strike on the issue, and the head of the Manufacturer's Association, Shraga Brosh. Ultimately, a compromise safety net plan was accepted by the Prime Minister and approved by the cabinet on December 14, with Finance Minister Bar-On voting against. The plan was discussed in the Knesset Finance Committee on December 15, with approval pending the MOF's submission of its full details over the next three weeks.

Fischer Says to Stay Focused

¶8. The issue of providing a safety net for the pensions became the

main focus of the economic and political echelon in dealing with the economic crisis. Governor of the Bank of Israel (BOI) Stanley Fischer said on 9 December that precious time that could have been used for the benefit of the economy was being wasted in wrangling over the issue. His comment followed the disclosure of significant tension between the Prime Minister's office and the Ministry of Finance over the issue. Fischer said that important decisions should not be delayed, and worried publicly that additional delays in executing steps would erode the achievements of the economy and the country's ability to successfully deal with the challenges that it faces. He stressed that the financial crisis is a reality and is not waiting for Israel to get its house in order. He added that the government has formulated the steps that are necessary and what remains is to implement them. Especially during this pre-election, Fischer emphasized the importance of focusing on dealing with the crisis; otherwise, the country will pay a heavy price.

MOF: Safety Net Unnecessary

¶9. The Finance Ministry does not believe that a safety net is necessary or appropriate. Cumulative gains in pension funds from 2004-2007 totaled 36 percent, with average annual returns in the eight percent range. In 2005, pension funds yielded about 12.5 percent on average. In comparison, average pension fund losses for the first ten months of 2008 were only about 13 percent. It has also been reported in the press that investors have recently reduced their withdrawals from long term savings funds to pre-crisis levels, a dramatic change from the near panic in the second half of September and October. However, due to intense political pressure, strike threats by the Histadrut, and unrelenting attacks in the press, the Ministry came up with a plan, which was immediately criticized from all directions. Most said that it was not expansive enough--that it did not cover enough of the assets of enough people. The Prime Minister and his bureau were among those pushing for a more generous plan. Even Former Finance Minister and Likud candidate for Prime Minister Binyamin Netanyahu consulted with Olmert about establishing a more generous safety net for the public's pension savings. Finance Committee Chairman Professor Avishai Braverman, who was running for a spot in the Labor Party Primaries, held the other economic plans hostage to the submission of a pension plan.

Net Provides Limited Coverage

¶10. Once approved, the pension safety net plan will use closing prices on November 30, 2008 as the base for performance measurement purposes. It will not be retroactive to losses incurred prior to that date. People between the ages of 57 and mandatory retirement age (67 for men, 64 for women) with up to NIS 1.5 million (USD 380 thousand) in pension savings will be covered. The MOF chose that limit after calculating that it was the amount a person needed in a pension fund to be able to provide a provide a monthly payout of about NIS 8000-the average monthly wage. However, only NIS 750,000 (USD 190 thousand) will be protected by the safety net, with the protected amount going down for those with smaller pension savings. The period of protection will be between 3 to 10 years, in accordance with the age of the pension saver. If the person is 57 today, the protection will be in effect for 10 years, until retirement. If the saver is 64 to 67, the period of protection will be for 3 years. There have been many different assessments of how much it will cost, ranging anywhere from little if the worst of the economic crisis has already passed up to as much as NIS 17 billion (about USD 3.9 billion). Some economists estimate that the cost of the benefits of the plan itself will be near zero, with the only costs involved resulting from the operation needed to administer it.

Why Should the Poor Subsidize the Rich?

¶11. In the 9 December issue of Ha'aretz, economic commentator Nechemia Strassler criticized the plan, saying that the hundreds of thousands of Israelis who do not have pension plans of their own

will be financing the bailout of those who do. He adds that setting up a "Safety Net Administration" will also be expensive and wasteful. Strassler and numerous other commentators agree with the MOF view that the plan will be difficult to execute as it will require careful examination of eligibility and data on pension savings. Economists at the investment house Psagot-Ofek wrote in a December 9 report that the pension savings plan should never have seen the light of day. They said that only in Israel was there a demand to supply a safety net for long-term savings, in spite of the fact that losses in Israel were lower than in many other countries. The reason for this is that people still remember that until a few years ago, pension insurance was fully financed or subsidized by the State, with pension holders invested primarily in special government-designated bonds.

¶12. Others, such as several economists at Harel Insurance writing in their in-house publication, said that the plan is reasonable and good both from a macro and microeconomic perspective. They praised its limited scope, saying that a more expansive plan with wide government guarantees would have encouraged riskier investing in the knowledge that the government would bail out those who lost money. The Harel economists also lauded the MOF's ability to stand up to the strong pressure to provide retroactive compensation for losses suffered previously. They noted that this indicates that the MOF will not let the budget deficit be significantly increased.

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Finance Minister: Revamp Pension Investing Completely
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¶13. Finance Minister Bar-On, speaking at a conference on December 9, said that in the future the MOF would propose a comprehensive regulatory reform that would define pension and long-term savings investment tracks based on age, which would reduce the risk and volatility of investments as a person ages. He said that it is important to take a long term view and to understand that the worldwide financial crisis obligates a deep global correction. This holds true for Israel as well, where there is a need to revamp long term savings structures and regulations.

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